#18-1757

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ATTORNEYS FOR Defendant Exidy, Inc.

SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SAN DIEGO

CINEMATRONICS, INC., a California corporation,

Plaintiff,

v.

VECTORBEAM, a California corporation; EXIDY, INCORPORATED, a California corporation; and DOES 1 through X, inclusive,

Defendants.

Case No. 451437

MEMORANDUM IN OPPOSITION TO PLAINTIFF'S REQUEST FOR A PRELIMINARY INJUNCTION

Date May 7, 1980 2SM
Time. 1:30pm
Dept. Dept. 17

Defendant EXIDY, INC., a California corporation, in response to plaintiff's request for a preliminary injunction and in support of said defendant's motion to dissolve the Temporary Restraining Order issued by this Court, April 22, 1980, submits the following points and authorities. Defendant requests that the preliminary injunction not issue on the following principal grounds:

1. Plaintiff, Cinematronics, has misled, defrauded and is in breach of its agreements with Exidy, and therefore does not

come before this Court with "clean hands".

2. Exidy has valid set-offs against the alleged royalties claimed and therefore no sums are due to Cinematronics.

3. The granting of an injunction will necessitate the laying off of over 40 technical employees of Vectorbeam, presenting a hardship to both defendant and its employees which greatly exceeds any benefit conveyed to plaintiff.

4. The Temporary Restraining Order in this case was improper.

5. The Temporary Restraining Order in this case was obtained with improper means and in disregard of a prior action pending between the parties in the Superior Court of Santa Clara County.

FACTUAL BACKGROUND

This case arises out of a transaction which occurred in late November and early December, 1979. At that time, defendant, Exidy, purchased from plaintiff, Cinematronics, all of the stock in a corporation known as Vectorbeam, located in the San Francisco Bay Area. Incidental to that purchase and at the same time, Exidy, Cinematronics and Vectorbeam entered into a Cross-Licensing Agreement for the mutual use of certain video game systems. This later agreement is attached to plaintiff's Complaint herein. The "Stock Purchase Agreement" between plaintiff and defendant provided, among other things, that the execution of the royalty agreement was a condition to defendant's obligation under the Stock Purchase

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Agreement. In fact, the two agreements were executed simultaneously.

1. Exidy's Complaint Against Cinematronics filed in Santa Clara County.

After Exidy had purchased Vectorbeam and become familiar with its operation, Exidy learned of a number of substantial variances between the true status and nature of Vectorbeam and what had been represented. As a result, Exidy sued Cinematronics in Santa Clara Superior Court for damages arising out of the misrepresentations made at the sale. A true copy of this Complaint is attached to the Declaration of Robert E. Schulz filed herewith. Highlights of the claimed misrepresentations include:

A. Cinematronics misstated the amount of non-obsolete inventory purchased by Exidy.

As part of the sale, Vectorbeam executed a $526,942 note to Cinematronics, which was then guaranteed by Exidy. A substantial amount of that note was based on inventory which was represented as current and usable. At the time of the purchase, Exidy inquired as to any "obsolete inventory" and was shown a negligible amount which was represented as the only valueless inventory. In fact, after taking over the company, Exidy learned that almost $325,000 of the inventory was obsolete and valueless and consisted in substantial part of artwork and specialized components to outdated or unsalable video games. In the Stock Purchase Agreement, Cinematronics represented that the inventory shown on financial statements given to Exidy

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was valued based on "generally accepted accounting principles consistently applied"(Paragraph 1(d)). Such principles would necessitate the writing-off of obsolete inventory which would have correspondingly reduced the purchase price and the amount of the note. Exidy has sued to reform the note to reflect the actual usable inventory.

B. Cinematronics refuses to execute a loan subordination agreement.

The parties agreed under paragraph 11 of the "Stock Purchase Agreement" that Cinematronics would subordinate its note to inventory and accounts receivable financing. Specifically the agreement provided:

> "This new Note will be subordinated under normal and usual terms with institutional lenders for inventory and account receivable financing such as the existing $150,000 and $295,000 notes are subordinated to the Bank of America."

Notwithstanding this clear provision, Cinematronics has failed and refused to sign a standard subordination required by Vectorbeam's bank and thus prevented defendants from obtaining receivables financing. It goes without saying that in the present credit market, such a deliberate failure to subordinate has had a crippling effect on defendants.

C. Levine Employment Contract.

Gil Levine was a Vice President-General Manager of Vectorbeam. It was represented to Exidy that Mr. Levine had an employment contract with Vectorbeam, but that this contract had been terminated and would not bind Exidy upon purchase of

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Vectorbeam. A written indemnification was given to Exidy by Cinematronics with respect to this agreement, and it was represented by Cinematronics that Levine had tendered his written resignation.

Since the purchase of Vectorbeam by Exidy, a claim has been made by Mr. Levine against both Vectorbeam and Exidy for breach of his alleged employment agreement. Defendants have tendered this claim to Cinematronics, but it has refused to defend or indemnify defendants.

Mr. Levine claims that immediately prior to the Vectorbeam sale to Exidy, Mr. Pierce, President of Cinematronics and Vectorbeam, refused to accept Mr. Levine's proffered resignation and in fact reinstated the employment agreement at an annual salary of $54,000 for a period ending December 31, 1983.

Defendant's potential liability on this claim is $216,000 plus attorney's fees.

D. Miscellaneous Irregularities and Set-Offs.

Numerous other undisclosed claims, contracts, bad-receivables, etc., have been discovered amounting to a figure in the neighborhood of $50,000. In addition, Cinematronics has failed to secure a consent of the Corporations Commission to the transfer of shares to Exidy, and despite repeated requests, has failed to turn over corporate books and records so as to enable Vectorbeam to conduct corporate business, elect Board of Directors, etc.

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As a result of these numerous and substantial breaches of the "Stock Purchase Agreement", Exidy filed a complaint against Cinematronics in the Santa Clara County Superior Court, a copy of which is attached to the Declaration of Robert E. Schulz. The Complaint was filed on April 17, 1980, prior to plaintiff's filing the within action. In response to Exidy's Complaint, Cinematronics filed the within action in San Diego County, and obtained an ex parte temporary restraining order.

2. Cinematronics' Feeble Attempt at Prior Notification of Temporary Restraining Order Application.

In an effort to comply with C.C.P., § 527(a) and give notice to defendants of its intent to request the Court for a temporary restraining order, Cinematronics alleges to have given notice to Exidy by leaving word with Mr. Robert Newson's answering service in Redwood City. It made no attempt to give notice to Exidy at its corporate headquarters as required under Paragraph 13 of the Licensing Agreement. Nor did it succeed in giving notice to anyone other than an answering service at 11:30 a.m. in Redwood City (San Francisco Bay Area) for a request for a temporary restraining order in San Diego at 4:00 p.m.

The purported notice to Vectorbeam is shocking! During the negotiations to purchase Vectorbeam, Cinematronics was represented by its counsel, Phillip Seymour DeCaro, a Portola Valley attorney. He negotiated the agreement on behalf of Cinematronics. He drafted the agreements.

After the consummation of the transaction, Mr. DeCaro

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requested note payments on behalf of Cinematronics and actually picked up the March, 1980 Promissory Note payment. On March 28, 1980, Mr. DeCaro, on behalf of Cinematronics, notified Exidy of Cinematronics' potential arbitration on a dispute over the "Stock Purchase Agreement".

Notwithstanding the fact that Mr. DeCaro was clearly Cinematronics' attorney and its attorney in this dispute, Cinematronics claims to have notified Vectorbeam of its desire to obtain a temporary restraining order, by leaving a telephone message with Mr. DeCaro's office at noon of the day of the request.

Needless to say, neither Exidy nor Vectorbeam were able to nor in fact appeared at the ex parte request for a TRO.

3. Effect of TRO.

The issuance of the TRO was intended to and will have the effect of terminating the operation of Vectorbeam since its production was exclusively in the building of games with the licensed vector generator system. As a result, 42 employees will be laid off, and all production will cease. This presents an obvious hardship to defendants and an equally serious hardship for 42 employees who are without work and without a job.

4. Defendants' Set-Offs Exceed Plaintiff's Claim.

As set forth above, the claimed set-offs by Exidy/Vectorbeam exceed the amount of plaintiff's claim. A recap of the above claims is as follows:

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Obsolete inventory	$325,000
Levine contract	215,000
Miscellaneous items	50,000
	$591,000

In addition to this, Exidy claims punitive damages for intentional misrepresentations incidental to the sale. The amount of claimed royalties along with the entire note do not exceed this amount.

LEGAL ARGUMENT

1. Because Plaintiff Cinematronics has not Come Before This Court With Clean Hands, the Court Must Deny The Relief Sought.

It is a fundamental principle of equity that a litigant must come into a court with clean hands. Webb v. Vercoe (1927) 201 Cal. 754. If he fails to do so he is not entitled to the relief sought regardless of the evidence in support of his allegations. De Garmo v. Goldman (1942) 19 Cal.2d 755, 761.

The burden is on the litigant seeking equitable relief to prove his clean hands. Belling v. Croter (1943) 57 Cal.App.2d 296.

Upon any suggestion that a plaintiff has not acted in good faith with respect to the matter upon which he bases his suit, it is the duty of the court of equity to inquire into the facts in that regard. It is not only fraud or illegality which will prevent a litigant from obtaining equitable relief; any unconscientious conduct on his part which is connected with the controversy will bar him from the forum whose very foundation is good conscience. Johnston v. Murphy (1918) 36 Cal.App. 469. Nor will equity aid one who is guilty of breach of contract

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connected with the transaction concerning which he asks for a decree in his favor. Harrison v. Woodward (1909) 11 Cal.App. 15.

From the very inception of the transactions between defendant Exidy and plaintiff Cinematronics, which resulted in the purchase by defendant Exidy of defendant Vectorbeam from plaintiff and in the execution of a mutual cross-license agreement, plaintiff Cinematronic's actions have been in bad faith, overreaching, fraudulent and malicious. Plaintiff's actions continue in that vein to the present date.

A. Plaintiff's attorney drafted the document which plaintiff sues upon.

In negotiating the above-mentioned transactions, plaintiff was represented by its attorney, Phillip S. DeCaro. Defendant Exidy was not represented by counsel. Acting in his capacity as attorney for plaintiff Cinematronics, and with knowledge that defendant Exidy was unrepresented, Mr. DeCaro drafted the Mutual Cross-License and Royalty Agreement, the Stock Purchase Agreement, the Corporate Installment Note and other incidental documents. In drafting the documents, Mr. DeCaro included every provision of conceivable advantage to plaintiff Cinematronics (set-off after two years, no disclosure of leased property). He omitted to provide even the most rudimentary protections for defendant Exidy. Defendant Exidy was not apprised of its rights in these negotiations, nor was it aware of contractual provisions which should have been included to protect Exidy's interests.

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Plaintiff's conduct in the negotiation and execution of the document sued upon, the Mutual Cross-License Agreement, was clearly overreaching, fraudulent and in bad faith. Such conduct constitutes "unclean hands" and precludes plaintiff's use of a court of equity to aid in the enforcement of the agreement.

B. Plaintiff has clearly and undisputably breached the Stock Purchase Agreement in several respects.

The breach of contract which, under the doctrine of unclean hands, bars the plaintiff from any right to equitable relief need not be a breach of the very contract plaintiff sues upon; rather, the test is whether plaintiff has breached a contract which is connected with the transaction on which he bases his right to relief. Harrison v. Woodward, supra. The test as to whether plaintiff's improper conduct is so connected with the transaction at issue as to bar equitable relief is whether plaintiff's acts complained of have infected the cause of action and whether they relate to the transaction concerning which the complaint is made. City of Los Angeles v. Watterson, 8 Cal.App.2d 331, 340.

As set forth above, it is clear that the Stock Purchase Agreement relates to the transaction concerning which the complaint is made. The purchase agreement and the license agreement were executed simultaneously. The execution of the license agreement was a condition to defendant Exidy's duty of performance under the purchase agreement.

It is also clear from the facts that plaintiff's breach

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of the Stock Purchase Agreement has infected its cause of action for breach of the licensing agreement. Plaintiff's refusal to subordinate the Corporate Installment Note to accounts receivable financing has seriously affected defendant Exidy's line of credit and its consequent ability to pay its obligations, including the royalty payments. Plaintiff has willfully placed defendants in an untenable position. Plaintiff has entered into agreements with defendants which obligate defendants to make payments of large sums of money; shortly thereafter, plaintiff, through its breach of an agreement, made it exceedingly difficult if not virtually impossible to obtain financing to make the required payments.

The fact that plaintiff has breached the purchase agreement in other respects is further evidence of plaintiff's unclean hands. Because of plaintiff's numerous breaches of the purchase agreement as set forth in the facts above, defendant Exidy has become contractually obligated to pay a grossly inflated price for the purchase of defendant Vectorbeam. This willful overvaluation of inventory, the deliberate inclusion of the Levine Employment Agreement and the improper allocation of accounts receivable and accounts payable on the part of plaintiff are evidence of plaintiff's unconscientious and fraudulent conduct in its dealings with defendants.

C. Plaintiff's refusal to accept defendant Exidy's tender of the royalty payments constitutes unclean hands which bars his right to seek injunctive relief.

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As set forth in the accompanying Declaration of H. R. Kaufman, defendant Exidy tendered payment to plaintiff of amounts due under the license agreement subject only to plaintiff's execution of the subordination agreement. Having refused to accept that tender of payment, plaintiff now comes into a court of equity and asks the court to shut down the entire operation of Vectorbeam.

Such a tactic is unconscionable. Plaintiff had the ability and the opportunity to accept payment of all amounts then due and owing under the license agreement. Having refused to accept the proffered payment, plaintiff cannot now come into a court of equity and ask it to force defendants to do the very act which plaintiff has rejected.

D. Plaintiff's filing of this lawsuit in spite of defendant's prior pending action v. plaintiff in Santa Clara County is further evidence of plaintiff's unclean hands.

Defendant Exidy, Inc., filed a Complaint for Damages and Reformation against plaintiff on April 17, 1980, in Santa Clara County Superior Court. Exidy's cause of action arises out of plaintiff's breach of the purchase agreement. Plaintiff's unseemly race to enjoin defendants in San Diego County Superior Court while defendants were attempting to assert their contractual rights elsewhere is overreaching conduct and further evidence of plaintiff's unclean hands.

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2. Defendant Exidy is Entitled to a Set-Off Against Plaintiff Cinematronics Which Far Exceeds Any Amounts Due to Cinematronics Under the Licensing Agreement.

It is well settled that a court of equity will compel a set-off when mutual demands are held under such circumstances that one of them should be applied against the other and only the balance recovered. Harrison v. Adams (1942) 20 Cal.2d 646, 648; Eistrat v. Humiston (1958) 160 Cal.App.2d 89.

C.C.P., § 431.70 provides that where cross-demands for money have existed between persons, and an action is thereafter commenced by one such person, the other person may assert in his answer the defense of payment in that the two demands are compensated insofar as they equal each other. Here cross-demands for money clearly exist between plaintiff and defendant. Plaintiff Cinematronics demands payments allegedly due from defendant Exidy; defendant Exidy demands payment from Cinematronics for breach of the Stock Purchase Agreement. Consequently, under C.C.P., § 431.70, defendants have the right to show that plaintiff's demands for money have already been compensated by offsetting them against defendant's demands insofar as they equal each other. As set forth in the facts above, defendant's legitimate demands far exceed plaintiff's request for royalty payments.

In determining whether to grant or deny this preliminary injunction, this court must consider the likelihood of plaintiff's success in the ultimate determination of plaintiff's rights as

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against defendant's. A preliminary injunction is not proper unless there is a "reasonable probability that plaintiff will ultimately prevail. Continental Baking Co. v. Katz (1968) 68 Cal.2d 512.

Plaintiff's numerous and indefensible breaches of the purchase agreement which have resulted in very substantial money damage to plaintiff when considered with the legal and equitable principles allowing a set-off of claims make it clear that it is virtually inconceivable that plaintiff could prevail in an ultimate determination of the rights of the parties to this action. Accordingly, plaintiff's request for a preliminary injunction should be denied.

3. The Hardship Caused to Defendants by the Granting of a Preliminary Injunction Would Far Outweigh any Hardship Imposed on Plaintiff by the Denial of Said Preliminary Injunction.

Even if plaintiff were to establish a right to the issuance of a preliminary injunction against defendants, under the doctrine of balance of hardship, the issuance of a preliminary injunction would be improper under the facts of this case.

That doctrine holds that a court will balance the hardship that will be occasioned to the defendant if the injunction is granted as against the inconvenience the plaintiff will suffer if it is refused. The doctrine applies with special force to applications for preliminary injunctions. 38 Cal.Jur.3d, Injunctions, § 30.

The hardship suffered by plaintiff if its request is denied

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would be negligible. Defendant Cinematronics tendered full payment of the royalties due to plaintiff on condition that plaintiff abide by the express terms of the Stock Purchase Agreement and subordinate Vectorbeam's note to accounts receivable financing. Plaintiff refused and continues to refuse to subordinate the note. Plaintiff could have chosen to honor its contractual commitment. Had plaintiff done so, defendant was prepared to make an immediate payment of royalties. It was within plaintiff's power to insure that the full royalty payment would be made, but plaintiff chose to ignore defendant's request for subordination of the note. Having chosen to follow this course, plaintiff cannot complain of severe hardship.

Further, since, as stated above, defendant's set-offs against plaintiff far exceed any liability of defendant's for royalty payments, plaintiff's damages if its request is denied are virtually non-existent.

If this court were to grant the preliminary injunction against defendants, that action would cause severe hardship to defendants and to the employees of Vectorbeam.

Vectorbeam is a corporation engaged solely in the manufacturing of electronic games using the vector generating systems which are the subject of the Mutual Cross-License and Royalty Agreement. If defendants are enjoined from utilizing that system, Vectorbeam will be forced out of business. Vectorbeam presently employs more than 40 people, many of whom are highly skilled electronics technicians. If the preliminary injunction is granted, plaintiff

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will be forced to lay off or terminate all of these employees. Such a course of action would work an extreme hardship on all of these employees, whose lives would be disrupted while they sought other employment. This court must also consider the relative hardship to those non-party employees which would be caused by the grant of the requested preliminary injunction. Keith v. Superior Court (1972) 26 Cal.App.3d 521, 526.

Similarly, defendants Exidy and Vectorbeam would be gravely injured by the issuance of a preliminary injunction and the consequent necessity of laying off or terminating more than 40 highly-skilled electronics workers. It is well known that there is an extreme shortage of competent, highly-skilled electronics workers in the San Francisco Bay Area. Vectorbeam's work force, once dissipated, will be irretrievably lost. It will be impossible for the defendants to rehire their highly-skilled work force when the preliminary injunction is terminated, since the workers will have been hired by other electronics firms.

4. Because Granting the Preliminary Injunction Would Cause Defendant to Suffer Irreparable Injury, Plaintiff's Request Should be Denied.

If this court were to grant the requested preliminary injunction, defendants, as well as their non-party employees, would suffer grave and irreparable injury. Defendant Vectorbeam, a corporation whose only business is the building of games under the licensed vector generating system, would go out of business. Defendant Vectorbeam's 42 employees would lose thier jobs and suffer consequent disruption and loss of accrued

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employment benefits. Defendant Exidy would be contractually obligated to pay vast sums of money as the purchase price for all of the issued stock of a virtually worthless corporation.

In contrast, the injury to plaintiff caused by denying the request would be negligible at best. Plaintiff's only damages are money damages which are readily compensable in a legal action. Further, plaintiff has already refused defendant's tender of the amounts due.

Equity may deny injunctive relief and relegate the plaintiff to his remedy at law if the benefit resulting from granting the injunction will be slight as compared to the injury caused defendant thereby. Pacific, Gas & Electric Co. v. Mirmette (1952) 92 Cal.App.2d 401. That is exactly the case here. Accordingly, plaintiff's request should be denied, and plaintiff should be required to seek redress for his asserted wrongs in an action at law for damages.

5. The Granting of the TRO was Improper.

C.C.P., § 527(a) provides in pertinent part that no temporary restraining order shall be granted without notice to the opposing party, unless facts shown in the affidavit or verified complaint show that irreparable injury would result to the applicant before the matter can be heard on notice and the applicant or his attorney certifies under oath that:

(a) within a reasonable time prior to the application he informed the opposing party or his attorney of the time and place of the application, or,

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(b) that he made a good faith attempt to inform the opposing party and his attorney but was unable to do so, or,

(c) that for reasons specified he should not be required to inform the opposing party or his attorney.

The notice to opposing party of an application for a temporary restraining order must be adequate to allow opposing counsel to respond. Cal. Rules of Court, Appendix, Div. 1, § 15. Plaintiff has absolutely failed to comply with any of the alternate notice provisions of C.C.P., § 527(a).

Plaintiff is well aware of the location of the officers and the names of the officers or managers of Exidy, Inc., and Vectorbeam. The very license agreement sued upon provides that notice to Exidy shall be given at its corporate office in Sunnyvale. Yet plaintiff did not notify any officer of either defendant nor contact the corporate office of either defendant. Neither did plaintiff make a good faith effort to notify the defendants or their attorney or their respective corporate offices. Rather, on the day of the hearing in San Diego, plaintiff gave purported notice to defendant Exidy by leaving a message with an answering service in Redwood City, and gave purported notice to Vectorbeam by leaving a message with plaintiff's own attorney in Portola Valley.

By no stretch of the imagination can these messages be characterized as proper notice or as a good faith effort to give proper notice adequate to allow opposing counsel to respond.

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CONCLUSION

For the above-stated reasons defendants respectfully request that plaintiff's request for a preliminary injunction be denied.

Respectfully submitted,

CRIST, CRIST, GRIFFITHS, BRYANT, SCHULZ & BIORN

ROBERT E. SCHULZ

Dated: May 1, 1980.

By _____
PATRICIA J. GEBALA

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